

VZCZCXRO7171
RR RUEHDA
DE RUEHC #4975/01 3022221
ZNR UUUUU ZZH
R 282211Z OCT 08
FM SECSTATE WASHDC
TO RUEHAK/AMEMBASSY ANKARA 6131
INFO RUEHDA/AMCONSUL ADANA 2506
RUEHIT/AMCONSUL ISTANBUL 2424
RUEHBS/USEU BRUSSELS
RUEATRS/TREASURY DEPT WASHINGTON DC 9925

UNCLAS SECTION 01 OF 02 STATE 114975

SENSITIVE
SIPDIS

E.O. 12958: N/A

TAGS: [EFIN](#) [TU](#)

SUBJECT: A/S SULLIVAN,S MEETING WITH TURKISH TREASURY
UNDER SECRETARY

¶1. (SBU) Summary: A/S Sullivan met with Turkish Treasury Under Secretary Ibrahim Canakci on October 12. Canakci acknowledged there were risks to Turkey from the global financial crisis but described the Turkish economy,s strengths. While the slowdown in global growth and roiled capital markets could hurt Turkey, lower oil prices could help. On a possible IMF program, Canakci said that Turkey would only have a program if the Fund and Turkey reached a common understanding on fiscal policy in the coming weeks. End Summary.

¶2. (U) A/S Daniel Sullivan met with Turkish Under Secretary of Treasury Ibrahim Canakci on October 12 on the margins of the annual meetings of the IMF and World Bank. A/S Sullivan noted his work on the economic dialogue and his multiple meetings with Turkish officials over the past two years. He recalled then Foreign Minister Gul's interest in developing the "unrealized potential" in bilateral economic relations and said that has been his goal.

The Global Crisis:

¶3. (SBU) U/S Canakci said he was at the G-20 gathering when President Bush made an unexpected appearance. Canakci said that the U.S. Treasury was doing a good job sharing information, saying he had been on numerous G-20 finance ministry conference calls. Canakci said "everyone sees the urgency of the issue and there is a consciousness of the need for joint action. He mused that "pessimism is contagious" but it may have helped concentrate people's minds. He commented favorably on the comments of the Chinese vice-minister at the Bank/Fund meetings and Canakci said, "no country is immune." He said the financial markets are just a reflection of macro imbalances. A/S Sullivan stressed the importance of countries not turning inward, to which Canakci agreed.

Impact on Turkey:

¶4. (SBU) A/S Sullivan congratulated Canakci on Turkey's generally strong economic performance in recent years and asked how the global crisis was affecting Turkey. Canakci said now "we have to prove our success is durable," and this is a "testing time for us, too." He said there would be an impact on Turkey, as a highly open economy: trade constitutes more than 40 percent of GDP. Non-residents hold almost 70 percent of the capitalization of the Istanbul Stock Exchange and 14 percent of the government securities market. He said the percentage is even higher for the most highly-traded issues. He said that foreign ownership of the banking sector is about 40 percent of total capital, specifying that this calculation includes both direct ownership and indirect ownership through shares traded on the stock exchange

15. (SBU) In Canakci's view, there are three aspects of the crisis that are affecting Turkey, two of which are negative and one of which is positive. First, the slowdown in global growth, especially in Europe will have a major impact. Second, tighter conditions in capital markets and capital flows to Emerging Markets will be important for Turkey. The positive development is the easing of oil prices. Canakci said the current account deficit for 2008 is projected at around \$55 billion or about 6.8 percent of GDP, but energy imports are also expected to be around \$55 billion, such that without energy imports, there would be no deficit. With all these impacts, Canakci expects sub-trend growth, easing of current account deficit pressure (6 percent of GDP current account deficit for 2009), and an easing of inflationary pressures. This environment should make inflation targets more attainable. In 2008, the inflation target was 7.5 percent but inflation is now projected to come in around 10 percent. Next year's target is 7.5 percent.

16. (SBU) Canakci went on to say major uncertainties remain. The outlook is highly dependent on capital inflows. He expects the Turkish economy to adjust to the external shock and sees his job as trying to smooth the adjustment. He insisted the fundamentals of the economy are strong, citing four strengths. First, public sector finances are sound. Second, the banking sector is very strong, both because banks are well-capitalized and liquid, with low non-performing

STATE 00114975 002 OF 002

loans, and also because the regulatory framework is strong. He said banks have only 3.1 percent non-performing loans on a gross basis and 0.6 percent on a net basis and banks have only minimal open foreign exchange positions. Several foreign banks with subsidiaries in Turkey (e.g. Fortis, Dexia) have had trouble at the headquarters level but not in Turkey.

17. (SBU) Another strength is in monetary policy and the foreign exchange regime. Turkey's independent Central Bank is following an inflation-targeting regime and the floating exchange rate regime acts as automatic stabilizer. Canakci pointed out how low household liabilities are: consumer loans are only 9 percent of GDP and housing loans are only 3.6 percent of GDP. Finally, Turkey's economy benefits from its diversified export base. The impact of a slowdown in Europe could be offset by the increased share of exports going to other markets. Whereas exports to the EU used to account for 57 percent of Turkey's exports, they now account for only 50 percent while exports to the Middle East and North Africa have grown from 10 percent to 18 percent.

18. (SBU) Despite these strengths, Canakci said Turkey needed to follow prudent policies to deal with any impact from the global crisis. Real interest rates were likely to stay high and growth will be weak. He said the Central Bank has been cautious and vowed that the Government will maintain fiscal discipline, via the 2008-2012 medium-term fiscal framework. This framework commits the Government to reduce public debt/GDP from 39 percent to 30 percent by 2012. The Government will keep the overall deficit to 1.4 percent of GDP and will adopt a fiscal rule, following a workshop with the IMF in December.

Possible IMF program:

19. (SBU) A/S Sullivan inquired about prospects for an IMF program. Canakci said the GOT has been discussing a possible program at the technical level since the end of the last IMF program in May. There will be a Fund mission next week with a particular emphasis on the 2009 budget. If there is a common understanding, particularly on fiscal policy, this could form the basis for a program. One major issue is the Government's desire to retain flexibility on public sector investment spending.

RICE